

City of Detroit

CITY COUNCIL

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TO: COUNCIL MEMBERS

FROM: Irvin Corley, Jr., Director *ICJ.*

DATE: January 31, 2007

RE: Information on the Veterans Memorial Building and Parking Garage
Lease Agreement Between the City of Detroit and UAW-Ford
National Education Development and Training Center (UAW-Ford)

During Council's recent deliberation over the Mayor's proposed Capital Agenda for 2007-08 through 2011-12, Councilwoman Barbara-Rose Collins asked me to provide the report I prepared regarding the aforementioned UAW-Ford lease. My report is attached.

Attachment

cc: Council Divisions

ICJ:\ICORLEY\Information on Veterans Memorial Building Lease 1995.doc

City of Detroit

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TO: COUNCIL MEMBERS

FROM: Irvin Corley, Jr. *ICJ.*
Acting Fiscal Analyst

DATE: September 5, 1995

RE: Veterans Memorial Building and Parking Garage Lease
Agreement Between the City of Detroit and UAW-Ford
National Education Development and Training Center
(UAW-FORD)

For the purpose of Council's discussion on September 7, 1995 regarding the Veterans Memorial Building and Parking Garage Lease Agreement, I am providing a report on my review of the lease agreement. Based on my analysis, it appears that several economic benefits would be derived by the City if Council should approve the lease agreement.

As Council is aware, there remains the public policy issue, which is should a public building in a major public space on prime City property be allowed to be converted into a private facility with limited public access. I understand that the City Planning Commission and the Research and Analysis Division will explore this issue in more depth for Your Honorable Body. Therefore, my review concentrates only on the economic benefits involved with the proposed lease agreement transaction, as described in detail below.

The Economic Benefits That Would be Derived by the City if the Veterans Memorial Building and Parking Garage are Leased to UAW-Ford

Appropriations and Revenues Associated With the Veterans Memorial Building Versus the Base and Additional Rent Available From the Lease Agreement

Appropriations and Revenues

Table 1 below shows the appropriations and revenues associated with the Veterans Memorial Building while being owned by the City for fiscal years 1992-93 through 1995-96.

Table 1
Veterans Memorial Building
Appropriations and Revenues
FY 1992-93 Through FY 1995-96

	FY 1995-96 (Projected in Redbook Budget)	FY 1994-95 (Actual)	FY 1993-94 (Actual)	FY 1992-93 (Actual)
Appropriations	(\$615,776)	(\$698,716)	(\$696,356)	(\$546,291)
Revenue	420,500	370,744	396,303	336,746
Shortfall	(\$195,276)	(\$327,972)	(\$327,053)	(\$209,545)

As Table 1 indicates, the Veterans Memorial Building has operated at an economic loss at least since FY 1992-93. Actual revenues, which represent primarily rental fees, have not exceeded \$371,000 in the last three (3) fiscal years, even with the Veterans Memorial Building being approximately 100% occupied.

The FY 1995-96 Redbook Budget assumes that the Veterans Memorial Building will close with an economic loss of (\$195,276) by the end of the fiscal year.

If amortized over 12 months, the economic loss would amount to (\$16,273) each month. Therefore, if the building is delivered to the tenant on November 1, 1995, the City would in the meantime suffer an economic loss of approximately \$65,100 for the period July 1 through October 31, 1995 while operating the building.

In addition, I understand it will cost the City approximately \$20,000 to move the City departments currently in the Veterans Memorial Building to other locations. Therefore, if the building is turned over to the tenant on November 1, 1995, the City would have paid out a total of \$85,100 (which represents the economic loss of \$65,100 plus the relocation costs of \$20,000) as a result of the lease transaction. If you compare the total pay out of \$85,100 to the economic loss of \$195,276 assumed in the FY 1995-96 budget for the entire year, the City will save about \$110,000 in the budget during this fiscal year if the Veterans Memorial Building is delivered to UAW-Ford on November 1, 1995.

Building Renovations and Base Rent

According to the lease agreement, UAW-Ford will spend at least \$10 million within 24 months to renovate the Veterans Memorial Building. It is important to note that all building renovations will be financed through UAW-Ford. Renovations include removing any asbestos from the building. The City simply does not have \$10 million to pour into the Veterans Memorial Building. The City could raise \$10 million through a \$10 million general obligation bond sale, but it would have to spend a substantial amount of money in interest as a result of these bonds.

The City will not receive any rent from the tenant during the first 18 months during the 2 year construction phase. Notwithstanding the abated rent for 18 months, the City will still save approximately \$195,300 a year as a result of not having to operate the Veterans Memorial Building. Then, after the first 18 months, the City will begin to receive a base rent of \$650,000 annually from the tenant, which far exceeds what the building currently generates in rental income (see Table 1 on previous page).

Additional Rent

In addition, beginning one year after the end of the 2-year construction phase, the City would be eligible to receive up to \$500,000 in additional rent annually if UAW-Ford is not successful in causing a minimum of 14,600 hotel rooms to be rented in connection with the use of the Veterans Memorial Building and Parking Garage.

If you divide the 14,600 hotel rooms into the \$500,000, the result of \$34.25 per hotel room represents the additional rent factor. Incidentally, the \$34.25 additional rent factor closely approximates what a person staying in a hotel room would spend a day on food, beverage, and miscellaneous items. If 14,600 hotel rooms are rented, then the City receives no additional rent. If, for example, only 10,000 hotel rooms are rented, then the additional rent the City would receive would be \$157,550, or 14,600 minus 10,000 times \$34.25. (Alternatively the rent of \$157,550 can be derived by following the formula as described in the lease agreement, which is to divide 14,600-10,000 by 14,600 times \$500,000.)

The City's Opportunity Cost Versus UAW-Ford's Investment Into the Veterans Memorial Building

Another way of analyzing the lease agreement is to look at what revenue stream the City may be giving up over the life of the

lease and compare that to the amount of the investment the tenant will make to renovate the Veterans Memorial Building. What the City gives up in potential revenue stream is entitled the opportunity cost.

The opportunity cost is derived as follows:

The City's triple net rental rate per square foot (1)	\$10.00
Less: the base rent per square foot (2)	<u>(5.36)</u>
Lost rent per square foot	<u>\$ 4.64</u>
Annual rent the City is giving up (3)	<u>\$563,129</u>
Total Opportunity Cost (4)	<u>\$6,562,705</u>

- (1) The City currently receives \$13.00 per square foot from tenants for rent, insurance, and utilities. Operating costs (insurance, utilities, etc.) represent about \$3.00 per square foot for the Veterans Memorial Building. Therefore, \$13.00 - \$3.00 per square foot equals the \$10.00 rent per square foot at "triple net".
- (2) Base rent per square foot of \$5.36 is derived by dividing the annual base rent of \$650,000 per the lease agreement by 121,364 square feet, which is the total square footage of the Veterans Memorial Building.
- (3) Annual rent of \$563,129 given up by the City is calculated by multiplying the lost rent per square foot factor of \$4.64 by the building's total square footage of 121,364.
- (4) Total opportunity cost equals the present value of the \$563,129 in annual rent derived in (3) above over the life of the lease, which is 25 years, assuming UAW-Ford exercised all of its lease renewal options.

Since the opportunity cost of \$6,562,705 is significantly lower than the \$10 million investment the tenant is willing to make to renovate the Veterans Memorial Building, it would be advantageous for the City to enter into this lease agreement with UAW-Ford.

Fair Market Value of Veterans Memorial Building and Land

At the end of each lease term, UAW-Ford has the option of purchasing the Veterans Memorial Building, the adjoining land, and parking garage.

Based on today's prices, the Assessor's Division of the Finance Department has determined that the fair market value of the shell of the building and the parking garage combined is \$4.25 million. The fair market value of the land is estimated to be approximately \$6.5 million. At the time the tenant exercises its purchase option, the building price will be adjusted for inflation and the fair market value of the land, the garage area below the parking garage and easements will be determined.

Obviously, if downtown Detroit becomes more marketable as a result of additional economic development, increased convention business, and increased entertainment business, the fair market value of the land could be significantly higher at the time of sale than its current value of \$6.5 million.

Potential Property Tax Revenues Generated by the Veterans Memorial Building

The Veterans Memorial Building is currently tax exempt property. If the building is leased by UAW-Ford and becomes a part of the tax roll, the building would generate approximately \$73,000 annually in property tax revenues.

Council should note that the UAW-Ford group is a nonprofit corporation. As a result, UAW-Ford may not be required to pay property taxes. However, UAW-Ford has recently indicated that if the Veterans Memorial Building remains tax exempt property under the terms of the lease, they would still be willing to pay a higher base rent amount sufficient enough to also cover property taxes that the building would generate as if it were leased by a for profit corporation.

Option to Expand: Lincoln Court

Under the lease term, UAW-Ford has the option to expand the Veterans Memorial Building and adjoining land by adding the Lincoln Court only for the purposes of constructing an addition to the existing building.

If the tenant elects to exercise this option, then the City will receive an additional \$50,000 annually as an addition to the base rent of \$650,000.

UAW-Ford may acquire the Lincoln Court at fair market value at the time they exercise their option to purchase the entire property associated with the Veterans Memorial Building. This would generate more revenues for the City at time of sale.

Potential Income Tax Revenues Generated From New UAW-Ford Employees

The UAW-Ford training center in the Veterans Memorial Building is expected to create about 200 new jobs for the City of Detroit.

Assuming that half of the new employees are residents and half nonresidents, the jobs would generate approximately \$225,000 in income tax revenues for the City.

Other Indirect Benefits Derived From the Lease Agreement

There are other indirect benefits that would be derived if UAW-Ford leases the Veterans Memorial Building and Parking Garage from the City.

First, there is a multiplier effect in regard to the additional business that will be generated from the new UAW-Ford employees and trainees coming to downtown Detroit. More money will be spent on local restaurants, gift shops, entertainment spots, etc., that will generate more revenue for the local business and increase income tax revenues for the City.

Another indirect benefit is the hotel tax that will be generated from the additional hotel rooms that will be rented as promised by UAW-Ford. The hotel tax is a 6% tax on the hotel room charge that is captured by the State to assist in the payment of the Convention Facility Limited Tax Revenue Bonds relative to the Cobo Hall expansion project.

Assuming that the average hotel room charge in downtown Detroit is \$90 per night, and 14,600 additional hotel rooms are rented annually as projected by UAW-Ford, the annual hotel tax generated for the Cobo bonds would equal approximately \$79,000 (14,600 times \$90 times 6%).

Parking Garage Analysis

According to the lease agreement, UAW-Ford is looking to also lease the adjacent 75-space underground parking garage.

I requested a five-year history on the operations of the underground parking garage from the Municipal Parking Department. As of this report date I have yet to receive the information. However, I did find out that the underground parking garage would not be a big loss to the Municipal Parking system because each year for the past five years the garage has ended up with a slight loss, the highest loss being \$6,000 in a given year.

Moreover, unlike other parking facilities owned and operated by the Municipal Parking Department, the underground parking garage revenues are not pledged as security to assist in the payment of the Municipal Parking Revenue Bonds.

In regards to the parking spaces now made available to the public via the underground parking garage, it appears that these spaces can be easily made available within the Cobo Hall Garage, Cobo Hall Arena, and Joe Louis Garage parking facilities at comparable parking rates.

Therefore, it appears that the leasing of the underground parking garage adjacent to the Veterans Memorial Building to UAW-Ford would not have a major fiscal impact on the City.

Summary

If Council should approve the Veterans Memorial Building and Parking Garage Lease Agreement between the City and UAW-Ford, then the following economic benefits would be derived for the City of Detroit:

- An economic savings of approximately \$195,300 annually in the General Fund budget.
- An annual base rental income of \$650,000, a level of rent that most likely would not be achieved if the Veterans Memorial Building continues to be operated by the City.
- A \$10 million (or more) investment made by UAW-Ford for Veterans Memorial Building renovations. The City, at the current time, simply does not have \$10 million to pour into the building.
- Potential additional rent up to \$500,000 annually if UAW-Ford is not successful in causing an additional 14,600 hotel rooms to be rented in a given year.
- An additional revenue of at least \$10.75 million for the City's General fund if UAW-Ford exercises its option to purchase the Veterans Memorial Building, the underground parking garage, and adjoining land.
- Additional property tax revenue, income tax revenue, hotel tax revenue, and other indirect benefits.

Veterans Memorial Building
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Of course, there remains the public policy issue which Council must wrestle with, which is should the City allow a public facility on prime City property to be converted into a private facility with limited public access.

Should Council have any further questions or concerns, please let me know.

IC/cyw

cc: Kathie Dones-Carson, RAD
Ray Cibor, Interim Auditor General
Marsha Bruhn, CPC
Mike Sarafa, Mayors Office
Ed Hannan, Budget Director

VMB.9-5.1C

EXECUTIVE SUMMARY - VETERANS MEMORIAL BUILDING

LEASE/OPTION TO UAW-FORD

- Entire Veterans Memorial Building to be leased, along with the adjacent 75 space underground parking garage.
- Tenant of the building to be UAW-Ford National Education Development and Training Center (NEDTEC), a Michigan nonprofit corporation controlled by Ford and the UAW.
- Building to be used only as a national office and training center for UAW-Ford personnel and related uses.
- NEDTEC to totally renovate interior of building at its expense; exterior appearance to remain essentially as is; first floor memorial plaques to be relocated on a prominent wall in Cobo Center.
- 5 year lease with options to extend for four more 5 year terms.
- Annual base rent of \$650,000, adjusted by any change in the Consumer Price Index at the beginning of each option term.
- NEDTEC entitled to 50% discount of rent of Cobo Center space up to maximum discount of \$100,000 per year of the lease term.
- Triple net rent, *i.e.*, all utilities, maintenance, and taxes to be responsibility of tenant.
- During each year of the lease term, NEDTEC personnel to rent at least 14,600 hotel rooms in Detroit in conjunction with use of Veterans Memorial Building, with Additional Rent of up to \$500,000 per year if such hotel rooms are not rented. (Additional rent proportional to amount the hotel rooms fall short of 14,600 rented per year.)
- Option to purchase at end of any lease term for price of \$4.25 million adjusted according to changes in the Consumer Price Index, plus the appraised fair market value of the land.
- Potential for expansion by NEDTEC adding additional wing or tower adjacent to and architecturally consistent with existing building, but not exceeding it in height.
- Public access along promenade in front of building not affected; however, NEDTEC will have an option to acquire the courtyard to the east of the northern part of the building for expansion (the Rogell Rose Garden where the Lincoln statue is located).